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IN THE

Supreme Court of the United States

OCTOBER TERM 1979

WOODLANDS TELECOMMUNICATIONS CORPORATION,

Petitioner,

v.

SOUTHWESTERN BELL TELEPHONE COMPANY,

Respondent.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Must a jury decide the effect of the Federal Communications Commission's authority to compel interconnection on Bell's monopoly power?

2. Must a jury decide whether Bell's refusal to interconnect complied with regulatory policy in determining whether Bell violated section 2 of the Sherman Act?

3. Must a jury deduct federal income taxes from lost profits in arriving at a damages verdict in an antitrust case?

PARTIES

Woodlands Telecommunications Corporation, Mid-Texas Communications Systems, Inc., Mitchell Energy & Development Corp., and The Woodlands Development Corporation were appelles below. Southwestern Bell Telephone Company was appellant below.

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OPINIONS BELOW

The opinion of the United States Court of Appeals for the Fifth Circuit is reported at 615 F.2d 1372. The opinion of the United States District Court for the Southern District of Texas denying motion to dismiss is reported at 447 F. Supp. 1261.

JURISDICTION

The judgment of the United States Court of Appeals for the Fifth Circuit was entered on May 1, 1980. The petition for rehearing en banc was denied on May 27, 1980. This Court has jurisdiction to review the judgment by writ of certiorari under 28 U.S.C. § 1254(1).

STATUTES

Section 2 of the Sherman Act, 15 U.S.C. §2, provides:

> Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony, and, on conviction thereof, shall be punished by fine not exceeding one million dollars if a corporation, or, if any other person, one hundred thousand dollars, or by imprisonment not exceeding three years, or by both said punishments, in the discretion of the Court.

Section 201(a) of the Federal Communcations Act, 47 U.S.C. §201(a), provides:

> It shall be the duty of every common carrier engaged in interstate or foreign communication by wire or radio to furnish such communication service upon reasonable request therfor; and, in acordance with the orders of the Commission, in cases where the Commission, after opportunity for hearing, finds such action necessary or desirable in the public interest, to establish physical

connections with other carriers, to establish through routes and charges applicable thereto and the divisions of such charges, and to establish and provide facilities and regulations for operating such through routes.

Section 186 of the Internal Revenue Code provides:

(a) Allowance of deduction. — If a compensatory amount which is included in gross income is received or accrued during the taxable year for a compensable injury, there shall be allowed as a deduction for the taxable year an amount equal to the lesser of —

(1) the amount of such compensatory amount, or

(2) the amount of the unrecovered losses sustained as a result of such compensable injury.

(b) Compensable injury. — For purposes of this section, the term "compensable injury" means —

(1) injuries sustained as a result of an infringement of a patent issued by the United States,

(2) injuries sustained as a result of a breach of contract or a breach of fiduciary duty or relationship, or

(3) injuries sustained in business, or to property, by reason of any conduct forbidden in the antitrust laws for which a civil action may be brought under section 4 of the Act entitled "An Act to supplement existing laws against unlawful restraints and monopolies, and for other purposes", approved October 15, 1914 (commonly know as the Clayton Act).

(c) Compensatory amount. — For purposes of this section, the term "compensatory amount" means the amount received or accrued during the taxable year as damages as a result of an award in, or in settlement of, a civil action for recovery for a compensable injury, reduced by any amounts paid or incurred in the taxable year in securing such award or settlement.

(d) Unrecovered losses. —

(1) In general. — For purposes of this section, the amount of any unrecovered loss sustained as a result of any compensable injury is —

(A) the sum of the amount of the net operating losses (as determined under section 172) for taxable year in whole or in part within the injury period, to the extent that such net operating losses are attributable to such compensable injury, reduced by

(B) the sum of —

(i) the amount of the net operating losses described in subparagraph (A) which were allowed for any prior taxable year as a deduction under section 172 as a net operating loss carryback or carryover to such taxable year, and

(ii) the amounts allowed as a deduction under subsection (a) for any prior taxable year for prior recoveries of compensatory amounts for such compensable injury.

(2) Injury period. — For purposes of paragraph (1), the injury period is —

(A) with respect to any infringement of a patent, the period in which such infringement occurred,

(B) with respect to a breach of contract or breach of fiduciary duty or relationship, the period during which amounts would have been received or accrued but for the breach of contract or breach of fiduciary duty or relationship, and

(C) with respect to injuries sustained by reason of any conduct forbidden in the antitrust laws, the period in which such injuries were sustained.

(3) Net operating losses attributable to compensable injuries. — For purposes of paragraph (1) —

(A) a net operating loss for any taxable year shall be treated as attributable to a compensable injury to the extent of the compensable injury sustained during such taxable year, and

(B) if only a portion of a net operating loss for any taxable year is attributable to a compensable injury, such portion shall (in applying section 172 for purposes of this section) be considered to be a separate net operating loss for such year to be applied after the other portion of such net operating loss.

(e) Effect on net operating loss carryovers. — If for the taxable year in which a compensatory amount is received or acrued any portion of a net operating loss carryover to such year is attributable to the compensable injury for which such amount is received or accrued, such portion of such net operating loss carryover shall be reduced by an amount equal to —

(1) the deduction allowed under subsection (a) with respect to such compensatory amount, reduced by

(2) any portion of the unrecovered losses sustained as a result of the compensable injury with respect to which the period for carryover under section 172 has expired.

STATEMENT OF THE CASE

At the conclusion of a six-weeks trial, a jury found that Southwestern Bell Telephone Company ("Bell") willfully used its monopoly power to exclude Woodlands Telecommunications Corporation ("WTC") from the telephone business at The Woodlands, Texas, and that WTC had suffered damages of $18,369,827. (R. 648). Pursuant to its jurisdiction under section 4 of the Clayton Act, 15 U.S.C.

§ 15, the trial court trebled damaged to $55,109,481 and entered judgment for WTC. (R. 695).

The Woodlands is a new town being developed on approximately 20,000 acres of previously uninhabited timberland near Houston, Texas (Tr. 1122), pursuant to the Urban Growth and New Community Development Act of 1970, 42 U.S.C. § 4501 *et. seq.* When completed, The Woodlands will have a population of 150,000 with extensive commercial, industrial, educational, and recreational facilities. Since there was no existing telephone service to this previously uninhabited area, the developer was required by the Department of Housing and Urban Development ("HUD") to arrange for telephone service to be provided. (PX 227). No state agency assigned service areas in Texas at this time so any telephone company was free to offer service. A number of companies, including Bell, made competitive proposals to the developer. (PX 63). The proposal of Mid-Texas Communications Systems, Inc. ("Mid-Texas") to form WTC to provide innovative services utilizing the latest technological advances proved to be the most attractive. A joint venture agreement was signed on August 30, 1972, between Mid-Texas and Mitchell Energy & Development Corp. (PX 83), and WTC was organized and began preparations to serve. (Tr. 1499-1507).

A new company unaffiliated with the Bell System must gain access to the interstate telephone network through interconnection with the nearest Bell System company. Keeping with its policy that "[e]ach system which is purchased and installed by one of our competitors means lost revenue to [our] company" (PX 59), and because it would set an example that it expected to be repeated in other new towns throughout the state of Texas (PX 93), Bell refused to interconnect with WTC. WTC filed a complaint requesting the Federal Communications Commission

("FCC") to compel the interconnection (PX 123) and tried other means to provide interim service until the FCC could act on the complaint. (Tr. 1532-78). Bell employed various tactics to prevent timely FCC action and thwarted each of the means WTC tried to provide interim service.

Finally, Bell resorted to economic coercion of Mid-Texas to force it to cause the FCC complaint to be withdrawn. Bell unilaterally changed the basis upon which it divided long-distance revenues with Mid-Texas in other areas of the state where Mid-Texas operated telephone companies and applied the change retroactively so as to backbill Mid-Texas for $160,000. (Tr. 1530-59). A Bell vice-president pressured the man who was president of both Mid-Texas and WTC to withdraw the FCC complaint, telling him that "The Woodlands case was a dangerous precedent-setting matter" (Tr. 1018); "Southwestern Bell would use all legal means to oppose such a dangerous precedent-setting filing" (Tr. 1018); even if he got an order compelling Bell to interconnect, he would still have problems getting Houston metro and intrastate connections (Tr. 1021-22); and that "it was going to be a long, hard battle." (Tr. 1022). Faced with this pressure and Bell's barricade of access to the interstate telephone network, WTC was forced to withdraw its FCC complaint so that Bell would provide service when The Woodlands was opened for public occupancy. (Tr. 1851).

REASONS FOR GRANTING THE WRIT

A writ should be granted in this case because: (1) it presents three important questions of antitrust law which should be settled by this Court; and (2) the Fifth Circuit has decided these questions in a way in conflict with applicable decisions of this Court and other circuits. Those questions involve the standards to be applied and the role

of the jury in determining the existence of monopoly power, the misuse of monopoly power, and the effect of federal income taxes on antitrust damages. A large number of cases involving the same issues are pending in the lower courts. In its Motion to Expedite Oral Argument in the Fifth Circuit, Bell advised the court that there are more than forty antitrust cases pending against Bell System companies and that "[t]he prompt resolution of the issues involved in this appeal could be invaluable, both to the parties and to the courts, in all of the antitrust cases pending against the Bell System, and possibly in a number of other such cases pending against regulated common carriers and public utilities."[1] The impractical and conflicting nature of the Fifth Circuit's decisions on these important questions makes it all the more imperative that this Court grant certiorari in this case. Experience has shown that trials of these cases impose heavy strains on the

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[1] Several courts have rejected the Bell System companies' attempts to dismiss plaintiffs' claims prior to trial on the basis of regulatory immunity; therefore, the same questions presented here must be faced in the trial of those cases. *See United States* v. *AT&T*, 427 F. Supp. 57 (D.D.C. 1976), *cert. denied*, 429 U.S. 1071 (1977), *cert. denied*, No. 77-1009 (D.C. Cir. 1977), *cert. denied*, 434 U.S. 966 (1977), *on reconsideration*, 461 F. Supp. 1314 (D.D.C. 1978); *MCI Communications Corp.* v. *AT&T*, 462 F. Supp. 1072 (N.D. Ill. 1978); *Litton Systems, Inc.* v. *AT&T*, 1980-1 Trade Cas. ¶ 63,246 (S.D.N.Y. 1980); *Southern Pacific Communications Co.* v. *AT&T*, No. 78-0545 (D.D.C. July 2, 1979); *Sound, Inc.* v. *AT&T*, 1979-2 Trade Cas. ¶ 62,974 (S.D. Iowa 1979); *Fox & Jacobs, Inc.* v. *AT&T*, No. S-77-77-CA (E.D. Tex. 1979); *Northeastern Telephone Co.* v. *AT&T*, 1979-1 Trade Cas. ¶ 62,548 (D. Conn. 1978); *Interconnect Planning Corp.* v. *AT&T*, 1979-1 Trade Cas. ¶ 62,655 (S.D.N.Y. 1978); *Jarvis, Inc.* v. *AT&T*, 1978-2 Trade Cas. ¶ 62,197 (D.D.C. 1978); *Chastain* v. *AT&T*, 401 F. Supp. 151 (D.D.C. 1975); *Macom Products Corp.* v. *AT&T*, 359 F. Supp. 973 (C.D. Calif. 1973); *Essential Communications Systems, Inc.* v. *AT&T*, 610 F.2d 1114 (3rd Cir. 1979).

time and resources of the courts, juries, and parties.[2] An authoritative resolution of these questions would reduce substantially the possibility of trial error and the risk of re-trials in all these cases, thereby providing a significant public benefit. This case is ideal for the resolution of these questions because it involves only discrete questions of the proper standards to be applied, questions that may be decided by this Court without any necessity of becoming enmeshed in a detailed consideration of the evidence. Consequently, answers to these questions here would provide guidelines applicable in all the other pending cases. Furthermore, the answer to the question regarding the effect of income taxes on damages will be applicable to all private antitrust suits.

I. THE IMPORTANCE OF THE MONOPOLY POWER QUESTION

The first question — Must a jury decide the effect of the FCC's authority to compel interconnection on Bell's monopoly power? — is important because it presents a fundamental question of the effect of regulatory authority on the existence of monopoly power and the role to be assigned to juries, if any, in resolving that question. The same fundamental question will be present in every section 2 case involving a regulated industry when an agency has

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[2] The trial of this case lasted six weeks and required five years to prepare. The recently completed trial of *MCI Communications Corp.* v. *AT&T*, 462 F. Supp. 1072 (N.D. Ill. 1978), covered a period of three and one-half months. Other recent trials of monopolization cases similarly have required protracted trials: *ILC Peripherals Leasing Corp.* v. *IBM Corp.*, 458 F. Supp. 423 (N.D. Calif. 1978) (six months); *SCM Corp.* v. *Xerox Corp.*, 463 F. Supp. 983 (D. Conn. 1978) (fourteen months); *United States* v. *IBM*, No. 69-200 (S.D.N.Y. 1969) (continuing into its seventh year); *Berkey Photo, Inc.* v. *Eastman Kodak Co.*, 603 F.2d 263 (2nd Cir. 1979), *cert. denied*, 100 S. Ct. 1061 (1980) (seven months).

authority to compel action by a recalcitrant monopolist. Since the Fifth Circuit's decision of that question confuses the nature of the pertinent inquiry and imposes an undue burden on the jury to decide a question it should not be asked to decide, review of the Fifth Circuit's decision is particularly justified.

One of the goals of the Federal Communications Act of 1934 was to make available a nation-wide communication service. 47 U.S.C. § 151. To achieve that goal, Congress allowed telephone companies to work out agreements for interconnection of their lines without regulatory licensing or supervision. When one company refused to interconnect voluntarily, however, Congress, in section 201(a) of the Act, 47 U.S.C. § 201(a), empowered the FCC to compel interconnection in the public interest. Bell argued that the mere existence of section 201(a) immunized it from application of the antitrust laws or, alternatively, prevented it from possessing monopoly power as a matter of law. The trial court rejected Bell's legal arguments, App. at A-37, and concluded that since Bell did not otherwise dispute that it controlled access to the facilities WTC needed to enter business, there was no issue of fact on the existence of monopoly power. Consequently, he instructed the jury that "Southwestern Bell has 'monopoly power' in the relevant market in this case in that Southwestern Bell controlled the essential facilities of long-distance lines and NNX codes to which competitors must have access to do business." (R. 624).

The Fifth Circuit agreed that Bell was not immune from the antitrust laws but held that the jury, not the trial court, should decide the question of the effect of section 201(a) on the monopoly power issue: "Whether Bell possessed sufficient power to exclude competition in light of section 201(a) is a question for the jury's consideration." App. at

A-26. The effect of the Fifth Circuit's decision will be to lend perverse justification to the criticism of juries' ability to decide antitrust cases[3] and is contrary to the current efforts to simplify and shorten jury trials of antitrust cases.[4] The difficulty the jury will experience in dealing with this question on remand and the similar questions to be faced by juries in the other pending cases stems not from any inherent shortcomings on their part, but rather from the fact that they are being forced to decide an abstract legal question instead of resolving a factual dispute.[5]

Stated simply, it makes no sense to ask a jury what the legal effect is of section 201(a) on Bell's power to control access to the interstate telephone network. That is a ques-

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[3] *See* Lynch, *The Case for Striking Jury Demands in Complex Antitrust Litigation,* 1 REV. OF LITIGATION 3 (1980); Harris & Liberman, *Can the Jury Survive the Complex Antitrust Case?* 24 N.Y.L. SCH. L. REV. 611 (1979); Comment, *The Right to an Incompetent Jury: Protracted Commercial Litigation and the Seventh Amendment,* 10 CONN. L. REV. 775 (1978); Note, *The Right to a Jury Trial in Complex Civil Litigation,* 92 HARV. L. REV. 898 (1979).

[4] REPORT TO THE PRESIDENT AND THE ATTORNEY GENERAL OF THE NATIONAL COMMISSION FOR THE REVIEW OF ANTITRUST LAWS AND PROCEDURES (1979); *Complex Litigation Materials: Proposed Procedural Revisions to Expedite the Resolution of Complex Antitrust Cases,* 48 ANTITRUST L. J. 663 (1980).

[5] It has been aptly noted that:

> All this [criticism] may say less about the jury system than about the laws juries are being asked to consider. If antitrust and securities cases are so difficult to comprehend it may be a sign that in those areas the law itself needs to be reconsidered. Might it also mean that juries are being forced to render legal judgments on the basis of legal theories that are losing touch with reality?

Shaffer, *Those Complex Antitrust Cases,* Wall St. J., Aug. 29, 1978, at 16, col. 4.

tion of law which should be decided by the court.[6] The same point was made in another monopolization case involving a regulated industry when the defendant complained of the trial court's refusal to instruct the jury to consider the effect of a regulatory statute:

> Greyhound complains of the district court's 'failure to instruct on section 5(11).' It is not clear precisely what Greyhound has in mind. The extent to which Greyhound's conduct was exempt from the antitrust laws by the Interstate Commerce Act was a legal question, not an issue of fact for the jury.

Mt. Hood Stages, Inc. v. *Greyhound Corp.*, 555 F.2d 687, 695 (9th Cir. 1977), *rev'd on another ground*, 437 U.S. 322 (1978).

Moreover, the Fifth Circuit's holding, that the existence of a remedial, regulatory statute may have the effect of preventing one from possessing monopoly power, conflicts with this Court's decision in an almost identical case, *Otter Tail Power Co.* v. *United States*, 410 U.S. 366 (1973). Otter Tail generated and transmitted electric power to a number of towns. When four of those towns decided to replace Otter Tail with independently-owned systems, they had to obtain wholesale power from Otter Tail or purchase it elsewhere and have Otter Tail "wheel" the power over its transmission network. Otter Tail refused to do either. Two towns filed complaints with the Federal Power Commission ("FPC") to compel interconnection under a statute, 16 U.S.C. §824a(b), which is nearly identical to section 201(a). One town was successful in obtaining such an order; an-

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[6] Professors Areeda and Turner have criticized the practice of some trial courts of leaving ultimate legal questions to be decided by juries. "[T]here is no excuse for leaving the jury to flounder on matters where it is ignorant or, at best, ill-informed." 3 P. AREEDA & D. TURNER, ANTITRUST LAW ¶ 315c at 54 (1978).

other town withdrew its complaint because it could not stand the delay and financial burden imposed; and two other towns were able to obtain power elsewhere. In affirming that Otter Tail's refusal to deal violated section 2 of the Sherman Act, this Court held: "The fact that three municipalities which Otter Tail opposed finally got their municipal systems does not excuse Otter Tail's conduct. That fact does not condone the antitrust tactics which Otter Tail sought to impose." 410 U.S. at 380-81. Since the fact that the FPC actually used its statutory authority to compel interconnection did not prevent Otter Tail from being held to possess monopoly power, the mere existence of substantially the same authority unexercised by the FCC certainly cannot prevent Bell from being held to possess monopoly power.[7]

II. THE IMPORTANCE OF AND CONFLICTING DECISIONS ON THE MONOPOLIZATION QUESTION

The second question — Must a jury decide whether Bell's refusal to interconnect complied with regulatory policy in determining whether Bell violated section 2 of the Sherman Act? — is important because it raises significant questions

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[7] Likewise, the authority of the Interstate Commerce Commission to order through-routing did not alter the unlawful nature of the refusals to deal in *United States* v. *Terminal Railroad Ass'n*, 224 U.S. 383 (1912), or in *United States* v. *Pacific & A.R.&N. Co.*, 228 U.S. 87 (1913). Similarly, the fact that other news agencies were available did not deter this Court from holding the Associated Press' refusal to deal unlawful in *Associated Press* v. *United States*, 326 U.S. 1 (1945). Other circuits also are in agreement on this point: "defendants may not be heard to say that they have not established a monopoly merely because they do not interfere with an outside warehouse if it can shift for itself"; *American Fed. of Tobacco Growers* v. *Neal*, 183 F.2d 869, 872 (1950); "The short answer to this [defendants' contention that they lacked monopoly power because other sites were available] is that a monopolized resource seldom lacks substitutes; alternatives will not excuse monopolization"; *Gamco, Inc.* v. *Providence Fruit & Produce Bldg.*, 194 F.2d 484, 487 (1952).

of the proper standard to be applied in assessing misuse of monopoly power and the proper context in which regulatory policy should be considered in antitrust cases. The Fifth Circuit's decision applies a standard in conflict with the standard applied by this Court and misplaces a duty on the jury to consider regulatory policy in determining whether a refusal to deal violates antitrust law.

The trial court followed the opinions of this Court in instructing the jury on the standards it was to apply in determining whether Bell misused its monoply power. He instructed the jury that the pertinent inquiry was whether Bell willfully maintained its monopoly power (R. 624), as stated by this Court in *United States* v. *Grinnell Corp.*, 384 U.S. 563, 570-71 (1966). In deciding that question, he instructed the jury that the use of monopoly power to foreclose competition or to gain a competitive advantage, or to destroy a competitor, is unlawful (R. 625), in accordance with *Otter Tail Power Co.* v. *United States,* 410 U.S. 366, 377 (1973), and *United States* v. *Griffith,* 334 U.S. 100, 107 (1948).

Although it discussed anticompetitive purpose or intent, the Fifth Circuit applied a different standard: "section 2 prohibits only those refusals to deal which under the particular circumstances of a case are unreasonably anticompetitive," App. at A-30, and held that the jury must resolve "the reasonableness of Bell's actions" under instructions from the trial judge "as to the relevant regulatory framework." App. at A-33.

A. THE MISUSE STANDARD

The Fifth Circuit thus abandoned the anticompetitive purpose or intent standard applied by this Court and adopted the "unreasonableness" standard advocated by the Sixth Circuit in *Byars* v. *Bluff City News Co.*, 609 F.2d 843,

853 (6th Cir. 1979). The Sixth Circuit in *Byars* expressed its dissatisfaction with this Court's standard and declared that "what should matter is not the monopolist's state of mind, but the overall impact of the monopolist's practices." 609 F.2d at 860. It decided, therefore, to apply a standard similar to the Rule of Reason applied in Sherman Act section 1 cases requiring determination "whether the monopolist's conduct is unreasonably anti-competitive and thus unlawful." *Id.*

This standard is not only in square conflict with the standard applied in *Otter Tail*[8] and this Court's other section 2 decisions[9] but also rejects the emphasis this Court has given to the overall importance of anticompetitive purpose. As recently as *McLain* v. *Real Estate Board of New Orleans, Inc.*, 100 S.Ct. 502, 509 (1980), this Court emphasized that "in a civil action under the Sherman Act, liability may be established by proof of *either* an unlawful purpose or an anticompetitive effect." [Court's emphasis.]

This conflict on so fundamental a point should not go unresolved. It will cause confusion in the lower courts and the application of different standards among the circuits;[10]

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[8] The Fifth Circuit said that *Otter Tail* did not determine this issue because, "*Otter Tail* did not present a case like the present one where the utility is arguing that its actions were justified by articulable public interest factors." App. at A-30 n.14. This attempted distinction is erroneous. The majority opinion reveals that Otter Tail did make such an argument: Otter Tail "assert[ed] that compulsory interconnection or wheeling will erode its integrated system and threaten its capacity to serve adequately the public." 410 U.S. 381. Justice Stewart's dissent deals with the argument in greater detail. 410 U.S. 389.

[9] *United States* v. *Grinnell Corp.*, 384 U.S. 563 (1966); *United States* v. *Griffith*, 334 U.S. 100 (1948); *Associated Press* v. *United States*, 326 U.S. 1 (1945); *Eastman Kodak Co.* v. *Southern Photo Materials Co.*, 273 U.S. 359 (1927).

[10] The Ninth Circuit also employed an "unreasonableness" standard in *California Computer Products, Inc.* v. *IBM Corp.*, 1971-1 Trade Cas. ¶ 62,713 (9th Cir. 1979). Other circuits have applied this

moreover, it disregard the reasons and necessity for policing the conduct of monopolists more closely under section 2 than the conduct of non-monopolists under section 1.[11]

B. CONSIDERATION OF REGULATORY POLICY

The Fifth Circuit's rejection of the established standard became all the more significant when it decided that the "unreasonableness" standard it had created required the jury to apply the public interest test of section 201(a) in determining whether Bell's actions were unreasonable. App. at A-30. That decision conflicts with applicable principles adopted by this Court on two related points: first, it misplaces consideration of regulatory policy by making it the standard for determining monopolization rather than limiting consideration to whether it conflicts with antitrust policy under the implied immunity doctrine; and, second, even if a Rule of Reason standard were applicable, it assesses reasonableness from the regulatory perspective rather than the antitrust perspective.

Court's anticompetitive purpose or intent standard. *Berkey Photo, Inc.* v. *Eastman Kodak Co.*, 603 F.2d 263 (2nd Cir. 1979), *cert. denied*, 100 S. Ct. 1061 (1980); *Smithkline Corp.* v. *Eli Lilly & Co.*, 575 F.2d 1056 (3rd Cir. 1978); *cert. denied*, 439 U.S. 838 (1978); *Sargent-Welch Scientific Co.* v. *Ventron Corp.*, 567 F.2d 701 (7th Cir. 1977), *cert. denied*, 439 U.S. 822 (1978); *Telex Corp.* v. *IBM Corp.*, 510 F.2d 894 (10th Cir. 1975), *cert. dismissed*, 423 U.S. 802 (1975); *Hecht* v. *Pro-Football, Inc.*, 570 F.2d 982 (D.C. Cir. 1977), *cert. denied*, 436 U.S. 956 (1978). Prior to its decision in this case, the Fifth Circuit also had applied the anticompetitve purpose or intent standard. *See Woods Exploration & Producing Co.* v. *Aluminum Co. of America*, 438 F.2d 1286 (5th Cir. 1971), *cert. denied*, 404 U.S. 1047 (1972).

[11] "There are kinds of acts which would be lawful in the absence of monopoly but, because of their tendency to foreclose competitors from access to markets or customers or some other inherently anticompetitive tendency, are unlawful under § 2 if done by a monopolist." *Sargent-Welch Scientific Co.* v. *Ventron Corp.*, 567 F.2d 701, 711 (7th Cir. 1977), *cert. denied*, 439 U.S. 822 (1978).

1. The Appropriate Context for Consideration of Regulation

On the first point, the purpose of the implied immunity doctrine is to determine which standard — regulatory or antitrust — Congress intended to apply to particular conduct.[12] It must be one or the other for plainly Congress did not intend that juries be required to make regulatory judgments in the context of deciding violations of the antitrust laws. Yet that is precisely what the Fifth Circuit's decision requires. In a prime example of circular reasoning, the Fifth Circuit holds that the antitrust laws are applicable to Bell's conduct but that the lawfulness of that conduct under the antitrust laws is to be judged under the regulatory standard.

The justification given for such curious reasoning is "public policy":

> This holding is based on the structure and effect of section 201(a) under which the FCC, upon appropriate demand, is empowered to determine whether a particular interconnection is in the public interest. The FCC's inquiry is controlled by its consideration of the public interest as informed by the general concerns of the Communications Act and prior adjudicatory decisions under section 201(a). As previously noted, it is possible that in certain situations, interconnection will not be in the public interest. . . . In those instances, public policy will be vindicated only if interconnection is denied. Prevention can occur only if the private utility denies interconnection in the first instance. Where the private concern properly denies an interconnection, it would be contrary to public policy to permit antitrust liability against it.

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[12] *See Gordon* v. *New York Stock Exchange*, 422 U.S. 659, 691 (1975); *United States* v. *National Ass'n of Sec. Dealers, Inc.*, 422 U.S. 694, 720 (1975); Note, *Antitrust and Regulated Industries: A Critique and Proposal for Reform of the Implied Immunity Doctrine*, 57 TEXAS L. REV. 751, 760-61 (1979).

App. at A-31. Consideration of public policy "based on the structure and effect of section 201(a)" is an appropriate inquiry, but solely in the context of determining whether Congress intended antitrust immunity for refusals to interconnect. It is that very structure and effect that compelled the conclusion that Congress did not intend to create such an exemption because it left the decision whether to interconnect, in the first instance, to the business judgment of the parties. If Congress had considered that prevention of undesirable interconnections was a paramount public interest, it would have made section 201(a) a licensing statute and prohibited all interconnections unless and until the FCC found them to be in the public interest. Having chosen instead to leave the matter to the business judgment of the parties, the logical corollary is that Congress also intended that if that business judgment was based on anticompetitive purpose or intent, its exercise should be penalized under the antitrust laws as well as being subject to compulsory order of the FCC.

Most importantly, the rationale for the Fifth Circuit's holding, that "it would be contrary to public policy to permit antitrust liability against [Bell if the interconnection would not have been in the public interest]," is contrary to this Court's holding in *United States* v. *Radio Corp. of America,* 358 U.S. 334 (1959), that antitrust liability may be imposed even when the FCC has approved expressly defendant's action as being in the public interest. *Accord California* v. *Federal Power Commission,* 369 U.S. 482, 489 (1962) ("approval of the transaction by the Commission would be no bar to the antitrust suit"); *see Otter Tail Power Co.* v. *United States,* 410 U.S. 366, 373 (1973).

Moreover, this supposed accommodation to public policy by incorporating the regulatory standard into the antitrust standard is unworkable. Neither trial judges nor juries are

equipped to assess the regulatory factors relevant to deciding whether the proposed interconnection would have been in the public interest.[13]

2. Application of the Rule of Reason

On the second point, the Fifth Circuit's holding that the reasonableness of Bell's refusal to interconnect must be judged under the public interest standard of section 201(a) conflicts with the principles regarding proper application of the Rule of Reason set out in *National Society of Professional Engineers* v. *United States*, 435 U.S. 679 (1978). This Court carefully explained the limited context within which the Rule of Reason is applied: "Contrary to its name, the Rule does not open the field of antitrust inquiry to any argument in favor of a challenged restraint that may fall within the realm of reason. Instead, it focuses directly on the challenged restraint's impact on competitive conditions." 435 U.S. at 688. In a passage that is particularly applicable to the case at hand, this Court said:

> The early cases also foreclose the argument that because of the special characteristics of a particular industry, monopolistic arrangements will better promote trade and commerce than competition. . . . That

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[13] In his analysis of the standards applied in monopolization cases, Professor Sullivan observes that "the judicial system, particularly the jury system, which can handle issues of conduct and even motive with some degree of comfort, is ill-equipped to deal skillfully with structural analysis." L. SULLIVAN, ANTITRUST LAW § 25 at 81 (1977). Further he says:

> If there is one task that judges and juries informed through the adversary system, may really be good at, it is identifying the pernicious in human affairs. To contend that the conventional formulation, which looks, in a sense, for evil, ought to be amended to one which looks solely to an effect validated by economic studies is to assume too much about the precision of applied economics and to assume too little about the value of more humanistic modes of inquiry.

Id. § 43 at 110.

> kind of argument is properly addressed to Congress and may justify an exemption from the statute for specific industries, but it is not permitted by the Rule of Reason.

435 U.S. at 689-90. The Court concluded its explication of the Rule by stating:

> [T]he purpose of the analysis is to form a judgment about the competitive significance of the restraint; *it is not to decide whether a policy favoring competition is in the public interest of the members of an industry. Subject to exceptions defined by statute, that policy decision has been made by the Congress.* [Emphasis added.].

435 U.S. at 692. Thus, the Fifth Circuit has held that the Rule of Reason must be applied in a manner and for a purpose directly contrary to what this Court has held is its true role and purpose.

The Ninth Circuit has made the point in a case involving the telephone industry. In *ITT Corp.* v. *GTE Corp.*, 518 F.2d 913 (9th Cir. 1975), the court explained that:

> If an activity is nonexempt, the antitrust laws apply with undiminished force, whether or not the activity is regulated. *Put another way, if a claim of exemption is rejected in an antitrust suit, the only pertinent frame of reference is the antitrust law.* The 'advantages' flowing from the challenged activity and purportedly fostered by the regulatory scheme become as irrelevant as they would be in the absence of any regulation whatsoever. [Emphasis added.]

518 F.2d at 935. The Fifth Circuit misunderstood the Ninth Circuit's further observation that regulation is not irrelevant from a *factual perspective.* The Ninth Circuit said that although regulation is to be assessed as another fact of market life, "[i]n the absence of an exemption claim, the

fact of regulation is significant, but not because it embodies a doctrinal scheme different from the antitrust law; the sole legal perspective is that afforded by the antitrust law." *Id.*

The Ninth Circuit illustrated what it meant by saying: "This was the approach taken in *United States* v. *Marine Bancorporation,* 418 U.S. 602 (1974)." 518 F.2d 936 n.85. The government there brought an action under section 7 of the Clayton Act challenging a proposed merger between two commercial banks. The government relied on the theory of potential competition, arguing that the merger would eliminate the possibility that the acquiring bank would enter the market *de novo.* State law prohibited the kind of branching that would have been necessary for the acquiring bank to enter the market *de novo.* The regulatory framework discussed there had nothing to do with the legal standard by which defendants' conduct was to be judged under the Clayton Act. That standard, the potential competition doctrine, was purely the creature of antitrust law. Defendants would have violated the Clayton Act under that doctrine if their merger would have reduced the possibility of increased competition in the market. State regulatory law was relevant only on the facts to which the doctrine was to be applied; that is, it was relevant, as a factual matter, to the possibilities that the acquiring bank could have entered the market *de novo.* It was not an alternative, potentially incompatible, test for judging the legality of the merger, nor were the state regulations on branching in any way introduced into the legal test for determining the legality of a merger under the potential competition doctrine. The regulations were relevant only on the facts. It was in this sense, and in this sense only, that the Court stated: "We further hold . . . that the application of the [potential competition] doctrine to commercial banking must take into account the unique federal and state regula-

tory restraints on entry into that line of commerce. Failure to do so would produce misconceptions that go to the heart of the doctrine itself." *Id.* at 627. The Fifth Circuit's quotation of this language, App. at A-33, is thus inapposite and it offers no support to the Fifth Circuit's decision here.

The conflict is clear: under the principles applied by this Court and the Ninth Circuit, once it is determined that Bell's actions are nonexempt, the lawfulness of Bell's action must be judged solely from the perspective of the antitrust laws; but the Fifth Circuit says that even though Bell's actions are nonexempt, their lawfulness is to be judged from the perspective of the regulatory standard. The need for uniformity and efficient utilization of judicial resources requires that this conflict be resolved so that the more than forty lower courts faced with this dilemma in the other cases pending against Bell System companies will know which standard is to be applied.

III. THE CONFLICT ON THE TAX QUESTION

The Fifth Circuit held that damages in an antitrust suit must be reduced by federal income taxes. App. at A-36. This holding is an unwarranted departure from this Court's precedent in *Hanover Shoe, Inc.* v. *United Shoe Machinery Corporation,* 392 U.S. 481 (1968). In *Hanover Shoe,* this Court addressed the issue of whether actual damages should be reduced by federal income taxes in an antitrust case. The Court acknowledged that an antitrust plaintiff is damaged only to the extent of after-tax profits, but pointed out that both actual and treble antitrust damages are taxed at the time of recovery under the rule of *Commissioner of Internal Revenue* v. *Glenshaw Glass Co.,* 348 U.S. 426 (1955). The Court held, therefore, that reduction of antitrust damages by federal income taxes is improper because it constitutes double taxation. The decision of the Fifth

Circuit is in direct conflict with that holding. Bell did not make this argument either in the trial court or on appeal and the Fifth Circuit's *sua sponte* holding fails to consider *Hanover Shoe* or the pertinent provision of the Internal Revenue Code ("IRC"); indeed, the only authority mentioned is this Court's recent decision in *Norfolk & Western Railway Co.* v. *Liepelt,* 100 S.Ct. 755 (1980). Consideration of these authorities will reveal that there is no basis for the Fifth Circuit's failure to follow *Hanover Shoe.*

A. EFFECT OF IRC § 186

In 1969, Congress enacted section 186 of the Internal Revenue Code, a very complex provision allowing a narrow and limited income tax deduction for cetain amounts recovered in connection with an antitrust injury. Although a cursory reading of section 186 might suggest that it affects the rationale supporting *Hanover Shoe,* a critical analysis of section 186 in light of its legislative history and the principles underlying income taxation reveals that section 186 has no impact whatsoever on the holding in *Hanover Shoe* or its underlying rationale.

An antitrust plaintiff still must include the entire amount of antitrust damages in gross income. Section 186 allows a deduction with respect to that amount only to the extent of the lesser of (1) the compensatory amount,[14] i.e., the amount of actual damages (excluding punitive damages)[15] reduced by costs of recovery (e.g., attorneys' fees, court costs)[16] or (2) the amount of net operating losses[17] sustained in prior taxable years, but only to the extent that losses attributable

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[14] IRC § 186(a)(1).

[15] Treas. Reg. § 1.186-1(c)(1).

[16] IRC § 186(c); Treas. Reg. § 1.186-1(c)(4).

[17] A net operating loss is an excess of allowable deductions over gross income. IRC § 172(c).

to the antitrust injury were sustained in those same years and only to the extent that those net operating losses were not previously deducted under IRC § 172.[18]

A close analysis of section 186 reveals that it allows a deduction with respect to antitrust damages only to the extent that the antitrust plaintiff was denied the tax benefit of income tax deductions customarily allowed in computing taxable income. Thus, the purpose and effect of section 186 is not to exempt any portion of antitrust damages from taxation, but rather to insure that the amount actually taxed upon recovery represents only taxable income[19] and does not include any amounts that would have been allowed as deductions but for the antitrust injury. This reading of section 186 is in accord with its legislative history.[20] At least one commentator has reached a contrary conclusion. *See* Comment, *The Role of Income Taxes in Determining Antitrust Treble Damages Awards,* 56 TEXAS L. REV. 293 (1978). That conclusion, however, is based on an entirely erroneous reading of section 186,[21] thus demonstrating the complexity of the section and its susceptibility to misinterpretation.

Since the entire amount of an antitrust recovery is still subject to taxation at the time of recovery to the extent

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[18] IRC § 186(a)(2); IRC § 186(d)(1), (3); Treas. Reg. § 1.186-1(d)(1), (3).

[19] Taxable income is the amount by which gross income exceeds allowable deductions. IRC § 63.

[20] See S. Rep. No. 552, 91st Cong., 1st Sess., *reprinted in* [1969] U.S. Code Cong. & Ad. News 2027, 2315.

[21] *See, e.g.,* the statement at page 296 that a plaintiff with no net operating losses could deduct the entire amount of actual damages. Obviously, a plaintiff with no net operating losses can deduct no portion of the antitrust award, since the deduction is limited to the *lesser* of the compensatory amount or prior net operating losses.

that it represents taxable income,[22] the holding in *Hanover Shoe,* that reduction of antitrust damages by federal income taxes is improper because it constitutes double taxation, remains viable.

B. EFFECT OF NORFOLK

In *Norfolk & Western Railway Co.* v. *Liepelt,* 100 S.Ct. 755 (1980), this Court held that damages must be reduced by federal income taxes in a case brought under the Federal Employers' Liability Act. Although the Fifth Circuit cited *Norfolk* in connection with its holding that antitrust damages must be reduced by federal income taxes, *Norfolk* is easily distinguishable. Personal injury damages are totally exempt from federal income taxation under IRC § 104 (a)(2); therefore, the danger of double taxation that concerned the Court in *Hanover Shoe* was not present in *Norfolk.* Nowhere in *Norfolk* did the Court purport to overrule *Hanover Shoe,* and *Hanover Shoe* is not inconsistent with *Norfolk* either in holding or in rationale.

A grant of certiorari is justified in this case by the Fifth Circuit's unwarranted departure from the precedent set in *Hanover Shoe.* This case provides an excellent opportunity for the Court to re-examine *Hanover Shoe* in light of the enactment of section 186 and the decision in *Norfolk* and to reaffirm its continued vitality. Guidance from this Court is extremely desirable because of the complexity of section 186, its demonstrated susceptibility to misinterpretation, and the needless complexity that will be injected into already complex antitrust cases if misguided courts continue to disregard *Hanover Shoe.* Before *Norfolk,* most courts refused to countenance the consideration of income taxes in any type of damages suit because of the concomi-

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[22] Or, more specifically, to the extent that it would have represented taxable income but for the antitrust injury.

tant speculation and complexity that overshadow the real issues in the case.[23] Although speculation and complexity may not justify the exclusion of income taxes from consideration in cases in which they are legally relevant, certainly the Court should take every opportunity to prevent such speculation and complexity in cases in which income taxes are legally irrelevant.

Review by this Court is particularly justified in view of the universal application of the Fifth Circuit's holding that antitrust damages must be reduced by federal income taxes. The implications of the holding could affect not only the forty pending Bell cases, and not only other section 2 cases involving a regulated industry, but all private antitrust cases. Unless this Court checks such unwarranted departures from *Hanover Shoe,* antitrust trials, which already impose strains upon judicial and individual resources, could become needlessly mired in the complexities of federal income tax law. The prompt resolution of this issue would benefit courts and litigants alike.

CONCLUSION

For these reasons, a writ of certiorari should issue to review the judgment and opinion of the Fifth Circuit.

Respectfully submitted,

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[23] *Norfolk & Western Railway Co.* v. *Liepelt,* 100 S.. Ct. 755, 757-58 (1980).

CERTIFICATE OF SERVICE

I certify that true and correct copies of this Petition for a Writ of Certiori were delivered to counsel for Respondent by placing same in the United States Mail, postage prepaid, addressed as follows:

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On the 5th day of August, 1980.

~~Louis Paine~~ David L. Orr